

## Message Text

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ACTION EUR-12

INFO OCT-01 IO-13 ISO-00 AID-05 CEA-01 CIAE-00 COME-00

EB-08 FRB-03 INR-07 NSAE-00 SP-02 STR-04 TRSE-00

LAB-04 SIL-01 OMB-01 AGRE-00 FEA-01 ERDA-05

DODE-00 FPC-01 H-01 INT-05 L-03 NSC-05 PM-04

USIA-06 OES-06 SS-15 ACDA-07 OPIC-03 XMB-02 /126 W

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R 221423Z APR 77

FM USMISSION EC BRUSSELS

TO SECSTATE WASHDC 3581

INFO ALL EC CAPITALS

USMISSION OECD PARIS

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TAGS: EGEN, EFIN, EEC, US

SUBJECT: APRIL 20-21-US/EC BILATERAL CONSULTATIONS - PART I.

THE WORLD ECONOMY

1. SUMMARY: THE FIRSTTOPIC IN THE APRIL 20-21 US/EC CONSULTATIONS -- THE WORLD ECONOMY -- CONSISTED OF AN EXCHANGE OF VIEWS ON PROSPECTS FOR ECONOMIC GROWTH, INFLATION, AND BALANCE OF PAYMENTS ADJUSTMENT, FOLLOWED BY ASSESSMENTS OF THE BEST MEANS OF PROVIDING FURTHER NEEDED INTERNATIONAL FINANCING RESOURCES. THE EC SIDE NOTED THAT EUROPEAN GROWTH PROSPECTS WERE NOT GENERALLY STRONG (OUTSIDE GERMANY) AND THAT INFLATION AND UNEMPLOYMENT WOULD CONTINUE TO BE MAJOR PROBLEMS. ON THE OTHER HAND, PAYMENTS ADJUSTMENT WAS IMPROVING. THE UNITED STATES GAVE A FAVORABLE VIEW OF ITS GROWTH PROSPECTS, AND QUESTIONED CONTINUING EXCESSIVE PAYMENTS SURPLUSES IN THE FRG AND THE NETHERLANDS. BOTH SIDES SUPPORTED THE WITTEVEEN INITIATIVE. BOTH ALSOFAVORED AN

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INCREASE IN IMF QUOTAS; THE UNITED STATES POINTED OUT THAT A NEED TO NEGOTIATE A SELECTIVE INCREASE COULD CAUSE A DELAY. THE EC WAS GENERALLY OPPOSED TO A NEW ALLOCATION OF SDR BUT WANTED TO IMPROVE THEIR QUALITY. END SUMMARY.

2. THE US/EC COMMISSION SEMI-ANNUAL BILATERAL CONSULTA-

TIONS WERE HELD IN BRUSSELS APRIL 20-21.

3. THE US DELEGATION WAS HEADED BY UNDER SECRETARY COOPER, AND ALSO INCLUDED ASSISTANT SECRETARY HARTMAN AND MESSRS ALBRECHT (EUR/RPE) AND BARRACLOUGH (EB/ITP/OT). PARTICIPANTS FROM OTHER USG AGENCIES INCLUDES MESSRS RAY (TREASURY), DATZ (COMMERCE), FEKETEKUTY (STR), WHITE (AGRICULTURE), AND KRAMER (LABOR). THE EC SIDE WAS HEADED BY COMMISSION VICE PRESIDENT WILHELM HAERKAMP, AND ALSO INCLUDED (INTER ALIA) COMMISSIONERS CHEYSSON, BRUNNER AND DAVIGNON, DIRECTORS GENERAL HIJZEN, MOSCA, WILLIAMS, RABOT AND KOHN.

4. THREE PLENARY SESSIONS WERE HELD COVERING THE WORLD ECONOMY AND MONETARY QUESTIONS; MTN, BILATERAL, AND OTHER TRADE ISSUES; NORTH-SOUTH ISSUES; AND ENERGY. POLITICAL DISCUSSIONS TOOK PLACE AT A WORKING DINNER. MESSRS COOPER AND HARTMAN ALSO MET SEPARATELY WITH THE MEMBER STATES' PERMANENT REPRESENTATIVES. THIS MESSAGE REPORTS ON DISCUSSIONS HELD ON THE WORLD ECONOMY AND MONETARY ISSUES. SEPARATE MESSAGES WILL COVER THE TRADE, NORTH-SOUTH, ENERGY AND POLITICAL DISCUSSIONS.

5. WORLD ECONOMY: HAERKAMP SAID THAT LACK OF INVESTMENT WAS KEEPING THE EC FROM ITS FORECASTED GROWTH TARGETS. HIGH UNEMPLOYMENT HAD IMPORTANT SOCIAL AND POLITICAL ASPECTS IN THE EC. IT WAS ALSO ENCOURAGING TRADE PROTECTION IN MANY COUNTRIES, WHICH POLICY MAKERS MUST RESIST, ALTHOUGH THERE MAY BE NEED FOR LIMITED OFFICIAL USE

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TEMPORARY PROTECTION OR TEMPORARY ASSISTANCE TO HARD-PRESSED SECTORS.

6. DIRECTOR GENERAL UGO MOSCA PRESENTED COMMISSION VIEWS ON ECONOMIC PROSPECTS IN THE COMMUNITY AND ON THE GLOBAL ECONOMIC FRAMEWORK. THE GOOD SIGNALS WERE COMING PRIMARILY FROM THE EXTERNAL SIDE, THE BAD FROM THE DOMESTIC SIDE.

7. ON THE FAVORABLE SIDE OF THE LEDGER, EXCHANGE MARKETS HAD BEEN BEHAVING WELL RECENTLY. IMPROVEMENTS WERE BEGINNING TO BE SEEN IN THE UK SITUATION, REFLECTING POLICY MEASURES, INTERNATIONAL SUPPORT AND NORTH SEA OIL. IN ITALY, DIFFICULT AND COURAGEOUS MEASURES HAD BEEN TAKEN WHICH COMMANDED WIDE INTERNATIONAL SUPPORT. IN THE CASE OF THE PRINCIPAL EC SURPLUS COUNTRY, THE FRG, THE CURRENT ACCOUNT SURPLUS WAS HIGH, BUT DECREASING AND BECOMING SMALLER IN RELATIVE TERMS. OUTSIDE THE EC, THE ENLARGED US DEFICIT WAS CONTRIBUT-

ING IN VALUABLE MEASURE TO THE ADJUSTMENT PROCESS.  
THERE WAS ALSO SOME IMPROVEMENT IN THE LDC AREAS. THE  
GLOBAL OIL DEFICIT, OF COURSE, WOULD BE WITH US FOR  
SOME TIME TO COME. FINANCING OF THESE DEFICITS HAD  
BEEN EASIER THAN EXPECTED, BUT THE NEED FOR CONDITIONALITY  
ARGUED FOR MORE OFFICIAL FINANCING.

8. ON THE DOMESTIC SCENE, SIGNALS WERE LESS CONFORTING.  
THE FROWTH PICTURE WAS NOT CLEAR. GROWTH IN THE EC AS  
A WHOLE IS LIKELY TO BE QUITE MODERATE, ON THE ORDER OF  
3-1/2 PERCENT, LESS THAN THE 4.3 PERCENT REGISTERED IN  
1976, AND NOT ENOUGH TO REDUCE UNEMPLOYMENT OR GIVE  
IMPETUS TO INVESTMENT. INFLATION RATES APPEAR TO BE  
VERY RESISTANT TO DOWNWARD MOVEMENTS.

9. REAL WAGES IN THEEC HAD GENERALLY STABILIZED. ONLY  
IN ITALY AND FRANCE WERE THERE STILL RAPID INCREASES.  
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HE ATTRIBUTED THIS RELATIVE SUCCESS TO THE FAVORABLE  
INFLUENCE OF INCOMES POLICIES. DEVELOPMENT IN PROFITS  
POSED A DIFFICULT DILEMMA. MARGINS HAD EARLIER BEEN  
ERODED AND NEEDED TO BE RESTORED AS A PREREQUISITE TO  
INVESTMENT. HOWEVER, THR RISE IN PROFIT MARGINS THREATENED  
TO UNDERMINE THE SOCIAL CONSENSUS WHICH WAS NEEDED FOR  
THE SUCCESS OF INCOME POLICIES.

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10. UNDER SECRETARY COOPER INDICATED GENERAL AGREEMENT ON THE OVERALL OUTLOOK AND POLICY STANCE. HE LISTED THREE SALIENT DIFFERENCES IN THE WORLD ECONOMY COMPARED TO A DECADE AGO: HUGE AND DURABLE OIL SURPLUSES, EXCEPTIONALLY HIGH UNEMPLOYMENT RATES, AND STILL EXCESSIVELY HIGH RATES OF INFLATION. IN HIS JUDGMENT-- AND THAT OF PRESIDENT CARTER -- CONTROL OF INFLATION THROUGH HIGHER UNEMPLOYMENT WAS AN EXCEPTIONALLY CLUMSY AND COSTLY WAY OF DEALING WITH THE PROBLEM. THERE WAS A TEMPTATION TO LOOK TO THE EXTERNAL SECTOR TO RELIEVE UNEMPLOYMENT AND REDUCE LARGE TRADE DEFICITS. THIS ALSO CREATED TEMPTATIONS OF PROTECTIONISM. RESTRICTIVE MEASURES WERE NO REAL SOLUTION (EXCEPT IN ENERGY WHERE THERE WAS A NEED TO CUT DOWN ON OIL IMPORTS). WHILE MOSCA HAD MENTIONED UNFAVORABLE SIGNALS FROM THE DOMESTIC SIDE, IT WAS HERE THAT GOOD SIGNALS WERE NEEDED. WHILE THE GERMAN SURPLUS MIGHT NOT BE SO LARGE IN RELATIVE TERMS, THE NETHERLANDS ALSO HAD A SURPLUS WHICH, WHILE LESS IN ABSOLUTE TERMS, WAS LARGE RELATIVE

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TO ITS ECONOMY. ON THE OTHER HAND, A NUMBER OF COUNTRIES BOTH INSIDE AND OUTSIDE THE COMMUNITY HAD NON-SUSTAINABLE DEFICITS. FROM THE GLOBAL POINT OF VIEW SOME INCREASE IN RAW MATERIALS PRICES WAS WELCOME SINCE IT WOULD IMPROVE THE PAYMENTS SITUATION OF SOME NON-INDUSTRIAL COUNTRIES, WHOSE SHARE OF THE TOTAL DEFICIT HAD BEEN SWOLLEN BY THE EARLIER DECLINE IN MATERIALS PRICES DOLLING THE RECENT RECESSION.

11. COOPER NOTED THAT OUR FORECAST FOR US REAL GROWTH WAS CONSIDERABLY MORE OPTIMISTIC THAN EC ASSUMPTIONS. JAPANESE AUTHORITIES STILL INSISTED THAT THEY WILL REACH THEIR HIGHER 6.7 PERCENT TARGET. GERMAN GROWTH PROSPECTS SEEM TO BE DEPENDING HEAVILY ON EXPORTS, WHICH WAS NOT GOOD FROM A GLOBAL POINT OF VIEW.

12. COOPER NOTED THAT PRICE DEVELOPMENTS IN THE UNITED STATES WERE LESS ALARMING THAN MIGHT BE INFERRED FROM RECENT SHORT-TERM MOVEMENTS IN OVERALL INDEXES. AGRICULTURAL PRICES HAD BEEN A MAJOR FACTOR. STILL, RECENT WAGE SETTLEMENTS WERE COMING IN VERY HIGH -- IN SPITE OF HIGH UNEMPLOYMENT, WHICH SUGGESTS THAT HIGH UNEMPLOYMENT WAS NOT AN EFFECTIVE WAY OF REDUCING INFLATION.

13. COOPER NOTED THAT THE DECLINE IN PROFIT MARGINS IN THE UNITED STATES WAS ALMOST ENTIRELY A CYCLICAL PHENOMENON. THE MAJOR DETERRENT TO INVESTMENT WAS LOW CAPACITY UTILIZATION. BUSINESS ALSO FEARS THAT GOVERNMENT MIGHT ADOPT STOP-GO POLICIES IN RESPONSE TO ACCELERATION IN PRICES. THE UNITED STATES HAD DECIDED TO WITHDRAW THE \$50 ONE-SHOT PERSONAL TAX REBATE SINCE CONSUMPTION DEMAND HAD BEEN VERY STRONG RECENTLY AND REBATES DID NOT NOW SEEM TO BE NEEDED TO PRODUCE THE HIGH LEVEL OF CONSUMPTION BUILT INTO THE US FORECAST. INTERNATIONAL MONETARY ISSUES: COOPER NOTED THAT, WHILE RECYCLING OF OIL SURPLUSES MIGHT BE VIEWED AS LIMITED OFFICIAL USE

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SUCCESSFUL IN THAT EXTREMES OF PROTECTIONISM HAD BEEN AVOIDED, THERE HAD ALSO BEEN A MAJOR PRICE PAID IN THE FORM OF THE DEEP RECESSION AND A HEAVY BUILD-UP OF INTERNATIONAL INDEBTEDNESS BY MANY COUNTRIES. MORE OFFICIAL FINANCING WAS NOW NEEDED TO BACK-STOP PRIVATE MARKETS AND TO ABSORB A LARGER PORTION OF THE FINANCING BURDEN. THE IMF HAD TAKEN AN INITIATIVE TO AUGMENT IMF FINANCING WITH A SPECIAL \$16 BILLION FACILITY, HALF OF THE NECESSARY RESOURCES TO BE PROVIDED BY SURPLUS OIL EXPORTING COUNTRIES. IF A FACILITY OF THIS SIZE COULD BE RAPIDLY IMPLEMENTED, THE OECD FINANCIAL SUPPORT FUND (FSF) WOULD THEN BE SUPERFLUOUS. BUT IF THERE WERE TO BE DELAYS, OR AN INABILITY TO OBTAIN RESOURCES ON AN ADEQUATE SCALE, THEN THE FSF WOULD BE A DESIRABLE COMPLEMENT. THEREFORE, THE USG WAS DEFERRING ITS DECISION ON WHETHER TO PUSH FOR CONGRESSIONAL RATIFICATION OF THE FSF.

14. MOSCA NOTED THAT THE EC HAD NOT REACHED COMPLETE UNANIMITY ON MONETARY ISSUES, BUT HAD ARRIVED AT A FAIRLY COMPREHENSIVE POSITION ON PROPOSALS FOR A NEW QUOTA INCREASE, NEW SDR ALLOCATION, AND THE WITTEVEEN SPECIAL FACILITY.

15. MOSCA SAID THE EC IS IN FAVOR OF AN INCREASE IN IMF QUOTAS, LEAVING OPEN THE AMOUNT. THEY ARE STRONGLY IN FAVOR OF THE NEW SPECIAL FACILITY, BEARING IN MIND, OF COURSE, THAT THE SIZE OF SUCH A FACILITY DEPENDS CRUCIALLY ON REACTION OF THE OPEC SURPLUS COUNTRIES. GENERALLY, THE EC IS AGAINST A NEW SDR ALLOCATION BUT IN FAVOR OF STRENGTHENING THE SDR ("IMPROVING ITS QUALITY"). THE EC WOULD SUGGEST THAT IMF EXECUTIVE DIRECTORS STUDY SEVERAL PROPOSALS IN THIS CONNECTION. HE HOPED THAT THE UNITED STATES WOULD SUPPORT SUCH A STUDY.

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16. COOPER EXPRESSED CONCERN THAT TO TRY TO NEGOTIATE A SELECTIVE IMF QUOTA INCREASE WOULD LEAD TO DELAY AND THEREFORE FAVORED A GENERAL PROPORTIONAL INCREASE. THE UNITED STATES WAS LEANING AGAINST A NEW SDR ALLOCATION NOW. HOWEVER, COOPER FELT THE ISSUE OF ADQUACY OF INTERNATIONAL LIQUIDITY DESERVED FURTHER STUDY. HE ADDED THAT THE UNITED STATES WOULD BE WILLING TO LOOK AT MEANS OF STRENGTHENING THE SDR. HINTON

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